### **EXCEPTION**



## OPEN MEETING AGENDA ITEM BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP Chairman

1

2

3

4

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

26

GARY PIERCE Commissioner

BRENDA BURNS Commissioner

SUSAN BITTER SMITH Commissioner

BOB BURNS Commissioner Arizona Corporation Commission

OCKETED

JUN 0 6 2014

DOCKETED BY

RECEIVED

1. JUN -6 P 2: 45

ORIGINAL

IN THE MATTER OF THE APPLICATION OF CHAPARRAL CITY WATER COMPANY FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASE IN ITS RATES AND CHARGES BASED THEREON DOCKET NO. W-02113A-13-0118

CHAPARRAL CITY WATER COMPANY'S EXCEPTIONS

#### A. INTRODUCTION

Pursuant to A.A.C. R14-3-110, Chaparral City Water Company ("CCWC" or "Company") files the following exceptions to the Administrative Law Judge's Recommended Opinion and Order ("ROO") dated May 28, 2014. Throughout this proceeding, CCWC has urged the Commission to consider this matter against the backdrop of EPCOR's purchase of CCWC from American States in 2011. Shortly before the closing of that acquisition, the Commission had entered its decision in CCWC's prior rate case. In that case, the Commission, using CCWC's actual capital structure, approved a rate increase for CCWC utilizing a 9.9 percent cost of equity.

<sup>&</sup>lt;sup>1</sup> Ex. A-13 (Decision No. 71308).

 $<sup>^{2}</sup>$  Id.

3

4

5

7

8

10

11

12

13

14

15

16

17

18

19

20

21

22

Since the test year in the last rate case, CCWC has invested more than \$15,000,000,<sup>3</sup> with much of that occurring under EPCOR's ownership.<sup>4</sup> It is uncontroverted that these recent investments by CCWC were prudent and that EPCOR, as a responsible owner of CCWC, has ensured compliance with Commission orders, rules and regulations and has continued to provide safe and reliable drinking water to CCWC's customers.<sup>5</sup> However, CCWC continues to strongly believe that certain of the recommendations by Staff and RUCO throughout this proceeding, and now certain findings of the ROO, send the wrong signals to responsible water providers such as EPCOR that have recently invested in Arizona utilities or may look to do so in the future. Although CCWC supports many of the findings of the ROO, three key findings of the ROO discourage continued investment and consolidation by doing the following:

- 1. Adopting a return on equity ("ROE") far below any return on equity recommended by the parties to this proceeding.
- 2. Adopting a new, costly depreciation methodology, without appropriately weighing the costs and benefits.
- 3. Rejecting CCWC's reasonable request for inclusion in this case of twenty-four months of deferred depreciation and AFUDC.

CCWC also supports the corrections to the ROO found in the Hearing Division Revised Amendment dated June 5, 2014 and supports its adoption. Furthermore, CCWC requests an amendment to address the funding of its Low Income Program as noted below.

#### **COST OF EQUITY B**.

The ROO properly rejects the recommendation of Staff and RUCO to use a hypothetical capital structure and instead properly uses the Company's actual capital

2

4589912 3

23

24

25

Ex. A-17 at 12; Ex. A-3 at 10.

<sup>&</sup>lt;sup>5</sup> Ex. A-3 at 10; Ex. S-6 at Ex. KS at 11-12; see also MCESD Compliance Status Report attached to Company's Application (Ex. A-1).

structure of 14.45 percent debt and 85.55 percent equity.<sup>6</sup> However, immediately following its proper rejection of Staff's and RUCO's hypothetical capital structure, the ROO recommends an unsupported lower ROE to address newly found concerns with CCWC's "equity rich" capital structure.<sup>7</sup> Despite the ROO's recommendation that the 8.65 percent ROE is reflective of the risk present in the capital structure, the ROO does not provide any explanation for the basis for this calculation. This is surprising and appears arbitrary, as the only parties to submit any testimony on this issue recommended that the Commission find the cost of equity to be 10.5 percent (CCWC), 9.35 percent (RUCO) and 9.6 percent (Staff).<sup>8</sup> As such, the ROO's recommended cost of equity is not supported by the recommendation of any party to this proceeding nor is it in line with other recent Commission decisions for utilities with similar or more equity-rich capital structures.

The Company's expert, Ms. Ahern, supported a cost of equity of 10.5 percent in this proceeding. The basis for this expert recommendation was fully set forth in Ms. Ahern's testimony and in the Company's briefs. Unlike Staff, which relied upon only one model, Ms. Ahern reached her recommendation of 10.5 percent by relying on the application of market-based cost of common equity models, including the Discounted Cash Flow ("DCF") model, the Risk Premium Model ("RPM") and the Capital Asset Pricing Model ("CAPM"), to the market data of the proxy group of nine water companies. 10

As properly noted by Ms. Ahern, risk premiums have increased since 2011, which is the date of the decision in the Company's last rate case. As such, given the increasing risk premiums from that date forward, and the finding of a cost of equity of

<sup>&</sup>lt;sup>6</sup> ROO at 35-36.

<sup>7</sup> POO at 40

<sup>&</sup>lt;sup>8</sup> ROO at 37-38.

<sup>,</sup> la

<sup>10</sup> Ex. A-10 at 25-42.

<sup>&</sup>lt;sup>11</sup> Ex. A-11 at 50-51.

9.90 percent in the Company's prior rate case, it is improper to adopt a lower cost of equity in this case. <sup>12</sup> It must also be noted that the adoption of the ROE in the ROO will not allow for the maintenance of the credit quality of CCWC's presently invested capital because it will not result in sufficient earnings or cash flow. <sup>13</sup> This reduced credit quality will negatively impact CCWC's ability to attract capital on reasonable terms with firms of similar risk. Ultimately, these factors will result in an increase in the cost of debt and an increase in the cost of common equity to compensate investors for the additional risk and those cost of capital changes will ultimately increase customers' rates. It is critical for CCWC to earn a reasonable return on its investment if it is to continue to receive the benefits of timely and responsible investment at the low cost currently being provided. As such, it is appropriate and critical for the long-term financial well-being of CCWC to adopt a higher ROE, such as the 10.5 percent recommended by Ms. Ahern. <sup>14</sup>

The testimony of RUCO and Staff also supports a higher cost of equity than that found in the ROO. In his direct testimony, Mr. Parcell, based upon consideration of all of the evidence, including CCWC's actual capital structure, recommended a cost of equity of 9.35%. Unlike Mr. Cassidy, who made an upward adjustment to his cost of equity recommendation between the time of filing his direct testimony and his surrebuttal testimony, Mr. Parcell, without explanation, made no adjustment during that time (except for the unwarranted adoption of Staff's hypothetical capital structure). Mr. Cassidy, Staff's cost of capital witness, based on his analysis of one model, the DCF model, recommended a cost of equity of 9.6 percent. For all of the reasons noted by Ms.

<sup>22</sup> Decision No. 71308.

<sup>&</sup>lt;sup>13</sup> The adoption of the vintage depreciation methodology and the rejection of the 24 month deferral request will also have a negative impact on cash flow and earnings.

<sup>&</sup>lt;sup>14</sup> The ROO's support for a lower ROE also contradicts Staff's own recommendation in its recent White Paper in which it urged the Commission to consider rate of return premiums in relation to utility acquisitions. Ex. A-33 at

<sup>15</sup> Ex. R-7.

<sup>&</sup>lt;sup>16</sup> Ex. R-8.

<sup>&</sup>lt;sup>17</sup> ROO at 37-40.

Q

Ahern in her testimony, these recommendations are unreasonably low. However, they highlight the fact that there is no support in the record for the ROE recommended in the ROO.

Undoubtedly, Staff and RUCO will claim that they would not have made the same recommendation absent the adoption of the hypothetical capital structure. However, the adoption of a ROE below that recommended by the parties requires the adoption of a risk adjustment and the record in this case does not provide any support for the proper amount of any downward risk adjustment. In fact, the only support for any adjustment in this case is the evidence offered by Ms. Ahern that any ROE recommended must be adjusted upward by .32 percent for credit risk and .40 percent for business risk. The credit risk adjustment is an appropriate adjustment taking into account the likely lower bond rating of CCWC (Baa1/BBB+) as compared to the bond rating of the proxy group of water companies (A3/A+/A). The business risk adjustment is an appropriate adjustment supported by Ms. Ahern that factors in the risk of CCWC due to its small size in relation the proxy group. As noted by Ms. Ahern multiple times in this proceeding, when these proper adjustments are made, the parties' recommendations are within the same range.

The ROO's recommendation is materially lower than recent Commission approved ROE's for companies with similar capital structures. It is worth noting that the ROO for the *Lago del Oro* matter, which is also scheduled to be heard on the June 10

<sup>&</sup>lt;sup>18</sup> RUCO cannot make such a claim as its own witness recommended 9.35 percent in his direct testimony using the Company's actual capital structure.

<sup>&</sup>lt;sup>19</sup> The ROO does not rely on any specific or supported downward adjustment to reach its recommendation of 8.65 percent.

<sup>&</sup>lt;sup>20</sup> ROO at 38-39; Ex. A-11 at 14-35.

<sup>&</sup>lt;sup>21</sup> Ex. A-10 at 43.

<sup>&</sup>lt;sup>22</sup> Id. at 44-45.

<sup>&</sup>lt;sup>23</sup> ROO at 38-39.

3

4

5

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

Open Meeting, recommends an ROE of 9.7 percent for an entity with a capital structure with 71% equity.<sup>24</sup>

A proposed amendment to address the ROE is attached as Exhibit A.

#### C. **Depreciation Expense**

In addition to the unsupported ROE, the ROO also requires CCWC to adopt a new depreciation methodology. Although there is no dispute that CCWC has not earned its authorized return since its current rates became effective, Staff and RUCO recommend, and the ROO adopts, a new depreciation methodology to address the alleged over depreciation of two plant accounts. This change is recommended even though the amount of depreciation expense adopted in the ROO and that recommended by CCWC is very similar.<sup>25</sup> In fact, as noted in the ROO and as testified to by Staff, CCWC's approach "fixes the issue for this case." <sup>26</sup>

Staff's proposed modified Vintage Method is a solution looking for a problem as there is no harm to ratepayers in the current rate case. Although Staff has referred to this approach as the Vintage Method, Staff has conceded that its recommendation is not the Vintage Method as recommended by NARUC.<sup>27</sup> Rather, Staff's "modified" Vintage Method is a creation of Staff that seeks to use the whole group depreciation rates set by Staff more than 10 years ago and use these rates for the "modified" method proffered by Staff.<sup>28</sup> Although CCWC does not dispute that the Commission has the authority to adopt a "rational and systematic" depreciation methodology, Staff's proposed methodology does not meet this criteria. What the evidence does support is that Staff has not analyzed many of the issues that a regulator must analyze in determining an appropriate depreciation methodology. Staff did not look at its required depreciation

6

4589912\_3

22

23

24

25

<sup>&</sup>lt;sup>24</sup> Recommended Opinion and Order dated May 27, 2014 (Docket No. W-O1944A-13-0215) ("Lago Del Oro ROO").

<sup>&</sup>lt;sup>25</sup> ROO at 17,

<sup>&</sup>lt;sup>26</sup> ROO at 24 fn, 150; Tr. at 950-51.

<sup>&</sup>lt;sup>27</sup> Ex. A-32 at 176-180; Tr. at 954; Staff's Opening Brief at 10-11.

Ex. A-34; Ex. S-6 at Ex. KS at 12-13.

rates to determine if they worked properly with its "modified" Vintage method.<sup>29</sup> And although the ROO finds that the costs of implementing such a system would not outweigh the perceived benefits, the record does not support such a finding. As CCWC intends to seek an accounting order allowing it to defer and recover these costs, this analysis cannot be ignored.

Rather than require a costly and time consuming change to increase the complexity of the depreciation methodology, a more appropriate approach, as reasonably requested by CCWC, would be to revise depreciation rates to more properly reflect the service lives of the group of assets for which Staff has taken issue.<sup>30</sup> In fact, in the *New River* matter, which Staff, RUCO and the ROO cite as support for this change in methodology, Staff itself recognized during that proceeding that a change in depreciation rates could remedy its concerns.<sup>31</sup>

EPCOR has operated CCWC in accordance with the depreciation methodology and depreciation rates ordered by the Commission in CCWC's prior rate cases. However, now it is argued by Staff and RUCO, and found in the ROO, that CCWC somehow acted inappropriately in relation to the depreciation of certain accounts in accordance with Commission orders. Unlike the *New River* matter, which the ROO cites as support for this change, there is no claim in this case that CCWC improperly depreciated accounts.<sup>32</sup> In fact, both Staff and RUCO concede that CCWC followed the requirements of its prior rate case decision in relation to depreciation.<sup>33</sup> There is also no claim that CCWC failed to make proper retirements, and once again both Staff and RUCO concede that this new approach to depreciation is not being driven by improper

<sup>&</sup>lt;sup>29</sup> NARUC guidance requires that depreciation rates be set for each vintage year, not the entire group as is being done here. Ex. A-32 at 176-80.

<sup>&</sup>lt;sup>30</sup> Company's Schedules at Sch. C-2; Tr. at 853-54.

<sup>&</sup>lt;sup>31</sup> Decision No. 74294 at 15.

<sup>&</sup>lt;sup>32</sup> Staff's Opening Brief at 11.

<sup>33</sup> Tr. at 932-34; 643-44.

3

4

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

retirements as was the case in the New River matter and other Commission dockets.<sup>34</sup> Given these facts, it is unreasonable and unnecessary for the Commission to adopt this drastic change to depreciation methodology.

CCWC has proposed a revised depreciation rate of 8% (12.5 years) for the pumping account and a revised depreciation rate of 10% (10 years) for the transportation equipment account.<sup>35</sup> This would address any concerns raised by Staff and would avoid a wholesale, unnecessary, and costly change to the Company's (and its affiliates') depreciation methodology.<sup>36</sup> Staff admitted at the hearing that the depreciation rate revisions would accomplish the same objective:

If you have evidence of over-recovery, it would suggest that the rate is probably too high. You know, Staff's position is Staff's position. Our first choice is just to exclude it. Okay? Lowering the rate on the overall amount effectively does the same thing, more or less.<sup>37</sup>

The ROO finds that CCWC has not provided sufficient support for its depreciation rates because it has not submitted a depreciation study.<sup>38</sup> The same can be said for the depreciation rates recommended by Staff in this case, as Staff's own witness was not familiar with the basis for its recommended rates.<sup>39</sup> If Staff's concerns, however, are valid, then there should be no dispute that the depreciation rates for the two accounts above are not correct. And because the ROO requires that CCWC file its next case by June 30, 2018, the Commission will have another opportunity to examine these rates at that time. If the Commission finds that there may be value in a change to the methodology, this should only be adopted with additional, extensive analysis and input from all interested and affected parties. In addition, CCWC will file a depreciation study

26

<sup>34</sup> *Id.*; see, e.g., Decision No. 74294 at 18. <sup>35</sup> Company's Schedules at Sch. C-2.

<sup>36</sup> Tr. at 853-54; Company's Schedules at Sch. C-2.

<sup>23</sup> 

<sup>24</sup> 

<sup>25</sup> 

<sup>&</sup>lt;sup>37</sup> Tr. at 950. <sup>39</sup> Tr. at 934-35.

<sup>&</sup>lt;sup>38</sup> ROO at 24.

in its next rate case to provide further support for any depreciation rates that do not align with Staff's standard depreciation rates.

It also must be noted that the Recommended Opinion and Order in the *Lago del Oro* matter, also being heard on the June 10, 2014 Open Meeting, rejected Staff's proposed vintage methodology and recognized the concern of "negative accumulated depreciation balances when depreciation is stopped on assets that have reached their estimated service lives." These negative balances "have the potential effect of permanently increasing rate base." This concern is not present with the broad group method, which further supports its continued use by CCWC.

For these reasons, the ROO should be amended to allow CCWC to continue its current depreciation methodology with the Company's proposed changes in the depreciation rates for the pumping equipment and transportation equipment accounts. A proposed amendment is attached as Exhibit B.

#### D. 24-Month Deferral of Depreciation and AFUDC

The discussion above highlights Staff's, RUCO's, and the ROO's concerns with the alleged "over-recovery" of depreciation expense. The same concern, however, is not expressed with regard to the under-recovery of depreciation expense. Depreciation, unless recovered in rates, immediately begins to drain a utility's earnings, resulting in reduced returns on equity. The inability to recover the return and the associated depreciation when new plant is put into service until a new rate decision is issued has long been referred to as "regulatory lag." The deferral request made by the Company, based on Staff's own recommendation, would help to alleviate that imbalance. Despite the ROO's finding that the "mechanism" is not properly explained or defined, this deferral request is not a mechanism in the traditional sense. CCWC has calculated and

<sup>25</sup> Lago Del Oro ROO at 11.

<sup>|| 41</sup> *[*6

<sup>&</sup>lt;sup>42</sup> Ex. A-6 at 13

<sup>43</sup> Id at 13-14

supported the amount of the deferral for this case that will be used to calculate the revenue requirement in this case. The amortization of the requested deferred debit of \$18,276 was calculated using the depreciation rates for the specific plant at issue. There is no need to make a calculation on a going forward basis as this debit will be used for the rates in this case and future cases until the deferred balance is reduced to zero. Given the 24-month period selected by the Company, there is no more that needs to be done in making that calculation. Furthermore, there is no risk, as raised by Staff and RUCO, that these amounts will also be recovered as part of the SIB mechanism. CCWC has made a very reasonable request in the amount of \$473,463 to reflect AFUDC and depreciation expenses on plant that was constructed and placed into service for that 24-month period, and the Company requests that it be adopted in this case and included in the Company's revenue requirement.

A proposed amendment to adopt the Company's deferral request is set forth in Exhibit C.

#### E. Rate Design

#### 1. Low Income Program

The Company has proposed and the ROO adopts a Low Income Program. However, the ROO does not include any mechanism to recover these costs. The Company has requested to spread this cost over the highest block consumption of Residential and Commercial customers, which totaled 392,580 kgals, resulting in a surcharge on the highest block for those customers of \$0.0573 per kgal (\$22,500 / 392580 kgals). The ROO adopts the Company's proposal. However, based on its review of the proposed rates, CCWC does not believe that the \$0.0573 per kgal was

ll

 <sup>44</sup> Id. at 14-15.
 45 Ex. A-2 at Sch. B-2 at 6.

<sup>46</sup> L

3

4

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

26

included in the highest consumption tiers. Accordingly, CCWC requests that the Commission amend the ROO to include the amounts in the highest tier rates.<sup>47</sup>

#### 2. Irrigation and Hydrants

CCWC appreciates the Hearing Division Amendment addressing the tiers for the irrigation and hydrant customers. However, CCWC continues to believe that the commodity rates used may not be correct in producing the recommended revenue for this case. CCWC is willing to work with Staff to verify the correct rates for purposes of the final decision.

RESPECTFULLY SUBMITTED this 6<sup>th</sup> day of June, 2014.

LEWIS ROCA ROTHGERBER, LLP

By

Thomas H. Campbell Michael T. Hallam

201 E. Washington, Suite 1200

Phoenix, Arizona 85004

Attorneys Chaparral City Water Company

ORIGINAL and thirteen (13) copies of the foregoing filed this 6<sup>th</sup> day of June, 2014, with:

The Arizona Corporation Commission Utilities Division – Docket Control 1200 W. Washington Street Phoenix, Arizona 85007

Copy of the foregoing hand-delivered this 6th day of June, 2014, to:

Steve Olea
Utilities Division
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

<sup>47</sup> This amendment can be accomplished by adding \$0.0573 to each of the highest tier rates in the residential and commercial classes. (e.g., 4.25 + 0.0573=4.3073).

1		
1	Lyn Farmer	Thomas F. Galvin Jr.
	Chief Administrative Law Judge,	Advisor to Commissioner Brenda Burns
2	Hearing Division Arizona Corporation Commission	Arizona Corporation Commission 1200 W. Washington Street
3	1200 West Washington Street Phoenix, AZ 85007	Phoenix, AZ 85007
4		Angela Kebric
5	Janice Alward, Chief Counsel Legal Department	Advisor to Commissioner Bob Bums Arizona Corporation Commission
3	Arizona Corporation Commission	1200 W. Washington Street
6	1200 W. Washington Street	Phoenix, AZ 85007
7	Phoenix, Arizona 85007	Laura Woodall
	Chairman Bob Stump	Advisor to Susan Bitter Smith
8	Arizona Corporation Commission	Arizona Corporation Commission
9	1200 W. Washington Street Phoenix, AZ 85007	1200 W. Washington Street Phoenix, AZ 85007
	,	
10	Commissioner Gary Pierce Arizona Corporation Commission	Trisha Morgan Aide to Chairman Bob Stump
11	1200 W. Washington Street	Arizona Corporation Commission
	Phoenix, AZ 85007	1200 W. Washington Street
12	Commissioner Brenda Burns	Phoenix, AZ 85007
13	Arizona Corporation Commission	Eric Van Epps
	1200 W. Washington Street	Aide to Commissioner Gary Pierce
14	Phoenix, AZ 85007	Arizona Corporation Commission 1200 W. Washington Street
15	Commissioner Bob Burns	Phoenix, AZ 85007
16	Arizona Corporation Commission 1200 W. Washington Street	Kelly Aceto
10	Phoenix, AZ 85007	Aide to Commissioner Brenda Burns
17	G	Arizona Corporation Commission
18	Commissioner Susan Bitter Smith Arizona Corporation Commission	1200 W. Washington Street Phoenix, AZ 85007
10	1200 W. Washington Street	•
19	Phoenix, AZ 85007	Robyn Berndt Aide to Commissioner Bob Burns
20	Amanda Ho	Arizona Corporation Commission
	Advisor to Chairman Bob Stump	1200 W. Washington Street
21	Arizona Corporation Commission 1200 W. Washington Street	Phoenix, AZ 85007
22	Phoenix, AZ 85007	Teresa Tenbrink
	Stava Count	Aide to Commissioner Susan Bitter Smith
23	Steve Court Advisor to Commissioner Gary Pierce	Arizona Corporation Commission
24	Arizona Corporation Commission	1200 W. Washington Street
25	1200 W. Washington Street Phoenix, AZ 85007	Phoenix, AZ 85007
	Inding I III 00007	
26		

1	Copy of the foregoing mailed this 6th day of June, 2014, to
2	Daniel W. Pozefsky, Chief Counsel
3	Residential Utility Consumer Office 1110 West Washington, Suite 220
4	Phoenix, Arizona 85007
5	Andrew J. McGuire David A. Pennartz
6	Landon W. Loveland Gust Rosenfeld, P.L.C.
7	One East Washington, Suite 1600 Phoenix, AZ 85004
8	Attorneys for Town of Fountain Hills
9	Lina Bellenir Vince Cannarsa
10	16301 E. Jacklin Drive Fountain Hills, AZ 85268
11	Gale Evan
12	Patricia Huffman 16218 E. Palisades Blvd
13	Fountain Hills, AZ 85268
14	Leigh M. Oberfeld-Berger 16623 E. Ashbrook Drive, Unit #2
15	Fountain Hills, AZ 85268
16	Tracey Holland 16224 E. Palisades Blvd.
17	Fountain Hills, AZ 85268
18	Leonora M. Hebenstreit 16632 E. Ashbrook Drive, Unit A
19	Fountain Hills, AZ 85268
20	Jayme Williams
21	
22	
23	
24	
25	

# 201 E. Washington St., Suite 1200 Phoenix, AZ 85004-2595

4589912 3

## LEWIS ROCA ROTHGERBER

#### **EXHIBIT A**

Pg.	35,	line	17	delete	"In	fairness	to	CCWC's'	,
-----	-----	------	----	--------	-----	----------	----	---------	---

Pg. 36, DELETE lines 1-2.

Pg. 36, line 6 through 10, DELETE three sentences, beginning with "We agree with Staff and RUCO . . . "

Pg. 40, line 20, DELETE sentence beginning with "However, for the reasons . . . "

Pg. 40, line 24, DELETE "8.65" and REPLACE with "\_\_\_".

#### PLEASE MAKE ALL CONFORMING CHANGES

·

#### **EXHIBIT B**

#### DELETE Pg. 23, line 16 through pg. 25, line 19 and REPLACE WITH:

The Commission's rules do not mandate a specific depreciation methodology, but require that the cost of depreciable plant adjusted for net salvage be distributed in a rational and systematic manner over the estimated service life of the plant. Although we have previously adopted in Decision No. 74294 Staff's vintage year depreciation method, we have rejected this approach in other matters. We also note that the broad group method used by CCWC is the depreciation methodology used by the great majority of water utilities in this state. We are also aware that a change to the depreciation methodology in this case will require EPCOR to adjust its methodology for all of its Arizona utilities, a process that the record shows will be very costly. The disputes raised by the parties to this case highlight the need to further examine this issue to avoid unintended consequences.

As Staff's witness testified, adjusting the depreciation rates in this case as proposed by CCWC will properly address depreciation expense in this case. We are also aware of Staff's claim that this adjustment will not address Staff's long-term concern that CCWC will continue to recover depreciation expense on assets that have been fully depreciated. Because there is no depreciation study in evidence in this case, we will require CCWC to submit a depreciation study to further support any depreciation rates that do not align with Staff's recommended rates in its next case (including the rates adjusted in this case), which we note must be filed by June 30, 2018.

CCWC's proposed adjustments to its depreciation rates in the Transportation Equipment and Pumping Equipment accounts are reasonable and will be adopted.

#### Pg. 60, lines 13 through 14, DELETE Finding of Fact 53 and REPLACE WITH:

53. CCWC should be required to continue using its existing depreciation rates, which are set forth in Hearing Exhibit S-6, Exhibit KS at Table A, except for the depreciation rates for the Transportation Equipment Account and the Pumping Equipment Account which shall be as proposed by CCWC.

#### Pg. 60, lines 15 through 17, DELETE Finding of Fact 54 and REPLACE WITH:

54. CCWC shall adjust its deprecation rates for the Transportation Equipment Account and the Pumping Equipment Account as proposed by CCWC. CCWC shall further file a depreciation study with its next rate case to support any depreciation rates that do not align with Staff's standard rates.

#### Pg. 63, lines 14 through 15, DELETE Ordering Paragraph and REPLACE WITH:

IT IS FURTHER ORDER that CCWC should be required to continue using its existing depreciation rates, which are set forth in Hearing Exhibit S-6, Exhibit KS at Table A, except for the depreciation rates for the Transportation Equipment Account and the Pumping Equipment Account which shall be as proposed by CCWC.

#### Pg. 64, Lines 1 through 3, DELETE Ordering Paragraph and REPLACE WITH:

IT IS FURTHER ORDER that Chaparral City Water Company shall file a depreciation study in its next rate case to support any depreciation rates that do not align with Staff's standard rates.

4589912\_3 16

# 201 E. Washington St., Suite 1200 Phoenix, AZ 85004-2595

## LEWIS ROCA ROTHGERBER

#### **EXHIBIT C**

DELETE Pg. 11, line 14 through Pg. 12, line 7 and REPLACE WITH:

The evidence in this case demonstrates that CCWC's request to include \$473,463 is reasonable and will account for an annualized deferred debit of \$18,276. These amounts are supported by the amortization and actual depreciation rates by account. In addition, given the time period of the deferral in this case, there is no possibility of overlap with amounts sought as part of the SIB mechanism. We find CCWC's request to be reasonable and will adopt it here.

4589912\_3